

Internal Revenue Service

Number: **202019010**

Release Date: 5/8/2020

Index Number: 1361.01-00, 1361.01-02,
1361.03-03, 1362.00-00,
1362.01-00, 1362.04-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:01

PLR-114370-19

Date:

December 16, 2019

LEGEND

X =

Trust 1 =

Trust 2 =

A =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

State =

Years =

Dear :

This responds to a letter dated June 17, 2019, and supplemental information, submitted on behalf of X by X's authorized representatives, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted and representations within, X was incorporated on Date 1, under the laws of State. Effective Date 2, X elected to be taxed as an S corporation. A was the grantor of Trust 1, a shareholder of X. A died on Date 3. Trust 1 was a permitted S corporation shareholder under § 1361(c)(2)(A)(ii) until Date 4. However, an Electing Small Business Trust (ESBT) election effective Date 4 was not timely filed for Trust 1. Accordingly, Trust 1 became an ineligible shareholder of X and X's S corporation election terminated on Date 4. On Date 5, Trust 1's shares in X were transferred to Trust 2. A timely ESBT election was not filed for Trust 2. If X's S corporation had not terminated on Date 4, it would have terminated on Date 5 upon the transfer of Trust 1's X stock to Trust 2.

X represents that Trust 1 and Trust 2 have at all times met the requirements of an ESBT within the meaning of § 1361(d)(3), except that the trustees of Trust 1 and Trust 2 did not make timely ESBT elections under § 1361(e)(3). X further represents that Trust 2 has not filed its income tax returns consistent with being an ESBT for Years.

X represents that, other than the failure to make valid ESBT elections, X has qualified as a small business corporation at all times since its election on Date 2. X further represents that X and its shareholders have treated X as an S corporation at all relevant times. In addition, X represents that X has filed its income tax returns consistent with having a valid S election in effect for all taxable years since X elected to be an S corporation.

X represents that its S corporation election termination was inadvertent and was not motivated by tax avoidance or retroactive tax planning. Further, X represents that X and its shareholders agree to make any adjustments required as a condition of obtaining relief under the inadvertent termination rule as provided under § 1362(f) that may be required by the Secretary.

LAW AND ANALYSIS

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(ii) provides that a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after such death may be an S corporation shareholder, but only for the 2-year period beginning on the day of the deemed owner's death.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1362(b)(1)(B), an electing small business trust (ESBT) may be an S corporation shareholder.

Section 1361(e)(1)(A) provides that an ESBT means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(1)(B) provides that the term "electing small business trust" shall not include (i) any qualified subchapter S trust (as defined in § 1361(d)(3)) if an election under § 1361(d)(2) applies to any corporation the stock of which is held by such trust, (ii) any trust exempt from tax under subtitle A, and (iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in § 664(d)).

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) provides that the trustee of an ESBT must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1.1361-1(m)(2)(iii) provides that the trustee of an ESBT must file the ESBT election within the time requirements prescribed in § 1.1361-1(j)(6)(iii) for filing a QSST election (generally within the 16-day-and-2-month period beginning on the day that the stock is transferred to the trust).

Section 1362(d)(2) provides that an S corporation election will be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in

such ineffectiveness or termination, steps were taken so that the corporation for which the election was made or termination occurred is a small business corporation; and (4) the corporation for which the election was made or termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's S election was inadvertently terminated within the meaning of § 1362(f) on Date 4 because Trust 1 became an ineligible shareholder of X. We further conclude that, if X's S corporation election had not terminated on Date 4, then it would have terminated on Date 5 when the X stock was transferred from Trust 1 to Trust 2. Pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 4 and thereafter, provided X's S corporation election is otherwise effective and not terminated under § 1362(d).

This letter ruling is subject to the following conditions: (1) Within 120 days from the date of this letter, an election to treat Trust 1 as an ESBT effective Date 4 and Trust 2 as an ESBT effective Date 5 must be made with the appropriate service center; and (2) X and its shareholders must file any necessary original or amended returns consistent with the relief granted in this letter within 120 days of this letter, including but not limited to income tax returns for all open tax years reflecting the treatment of Trust 2 as an ESBT. A copy of this letter should be attached to the ESBT elections and any original or amended returns. If these conditions are not met, then this letter ruling is null and void. Furthermore, if these conditions are not met, X must send notification that its S election has terminated to the service center with which X's S election was filed.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representatives.

Sincerely,

Joy C. Spies

Joy C. Spies

Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2)

Copy of letter

Copy of letter for §6110 purposes

cc: